

**BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001**

**Regulations Establishing System  
Of Ratemaking**

**Docket No. RM2007-1**

**Prepared Testimony Of Mury Salls**

**On Behalf Of**

**DST Systems, Inc., DST Output, Inc. and DST Mailing Services, Inc.**

(Kansas City, Missouri June 22, 2007)

Good morning Chairman Blair and Commissioners. My name is Mury Salls. I am the Senior Vice President for DST Mailing Services, Inc. (DST Mailing). I appreciate the opportunity to present testimony on the Postal Regulatory Commission's development of a modern rate regulation system for market dominant postal products and my company's expectations, hopes and concerns about what will come from the process that the Commission is embarking upon.

After receiving my accounting degree in 1983, I started work in the disbursement accounting department of Pacific Bell, then a large telecommunications company. I held various management positions in accounting and finance. By 1989, I was responsible for the budgets for the chief financial officer's organization, which included technology and billing. In late 1989, I received word that the Postal Service was planning to file a rate increase that would increase my Company's postage costs by nearly 25 percent, an increase that would have had a material adverse impact on Pacific Bell's finances and telecommunications business. This matter was so important that the Chief Financial Officer relieved me of my normal duties so that I could focus on reducing the impact of the planned rate increase on the Company. Within a few weeks an acquaintance of mine and I contacted all the other large telecommunication companies and two cable TV billing providers and, shortly thereafter, formed Major Mailers Association (MMA) in order to intervene and represent the interests of high quality, large volume First-Class workshare mailers in the R90-1 omnibus rate case. My boss was so pleased with the outcome of the R90-1 case that I was promoted to coordinate and oversee all of Pacific Bell's postal activities.

Although I have changed employers over the years, my career has focused on the mailing industry and I have continued my involvement with MMA. I have served as Chair of the MMA rate committee in every rate case since R90-1. In this capacity, I have primary responsibility for MMA's participation in omnibus rate and classification proceedings and have presented testimony on behalf of MMA in Docket Nos. MC95-1 and R2000-1. For the last thirteen years, I have also served as President of the association. In that time, MMA membership has expanded to include the telecommunications, utility, insurance, financial services, and mailing services industries. I have also been active in the First Class Industry Subcommittee of the Mailer's Technical Advisory Committee (MTAC) and served as Co-Chair of that Subcommittee for four years. DST representatives serve on the boards of the National Postal Policy Council (NPPC) and the Association for Mail Electronic Enhancement (AMEE).

**I     Overview Of DST Companies Operations**

DST Mailing is a subsidiary of DST Systems, Inc (DST), which provides comprehensive, sophisticated information processing and computer software products and services to support the mutual fund, investment management, insurance and healthcare industries. In addition to technology products and services, DST provides single-source, integrated print and electronic statement and billing solutions through its subsidiary, DST Output. DST Output offers customized account statement and bill production, marketing services, postal optimization and alternative electronic solutions in the U.S., Canadian and U.K. markets.

DST Output's U.S. operations mailed approximately 1.9 Billion pieces in 2006, up 6.7 percent from 2005. The majority of these volumes are First-Class letters and flats. As described more fully later in my testimony, DST Output mails approximately 5 million pieces of mail each day from three modern facilities that operate 24 hours a day, 365 days a year.

DST Mailing Service was created in 2006 to consolidate postal related functions, including postage procurement, for all DST companies. DST Mailing analyzes and communicates all regulatory changes, such as postage increases and changes in Postal Service mail entry requirements, to all DST companies their clients, provides oversight for postal compliance, management of postage payment systems, and works

closely with Postal Service representatives at all levels when service or quality issues arise.

DST has worked closely with the Postal Service for nearly 30 years, piloting several key programs, such as the first manifest mail system in 1984 and implementing the new requirements, including presort software, two months ahead of the classification reform cutoff date in 1996 so that the Postal Service could evaluate the impact on mailers. More recently, DST has cooperated with the Postal Service by installing several **Postal One!** automated mail processing and transportation management systems and testing special encoding software for the intelligent mail barcode.

## **II Implementing A Modern System Of Rate Regulation For Market Dominant Products**

DST has been involved in every major rate case since 1990 and the reclassification that came about as a result of the MC95-1 proceeding. In these cases, the Postal Service often sought larger than average rate increases for First-Class single piece and workshare mailers. Although the existing ratemaking process is cumbersome and expensive, DST took considerable comfort in the opportunities it has afforded to persuade the Commission to be critical of the often-questionable methodologies employed by the Postal Service to justify larger than average increases for First Class.

The establishment of a workable new postal rate making system is of vital importance to DST, the clients it serves and all other workshare mailers. Any change brings with it opportunities and pitfalls. The change required by the new law is no exception. Properly implemented, the modern system of rates can provide greater financial certainty and security for the Postal Service and a welcome measure of rate stability and predictability for First Class workshare mailers.

DST's primary concerns with the new law are (1) how application of the revenue increase cap will be implanted at the class level, especially in First-Class in light of the integer constraint applicable to the basic rate for First Class single piece mail, (2) the scope of workshare activities that will be included within the definition of worksharing and (3) the manner in which workshare cost savings will be measured. I will also address briefly the development of reasonable delivery standards and methodologies for determining how well the Postal Service is meeting those standards.

**A. How Application Of The Revenue Increase Cap Will Be Implanted At The Class Level**

DST's clients use First-Class workshared mail primarily to invoice, provide account statements, make disbursements, and send other critical, time sensitive communications to their customers. Postage usually represents the largest single expense in the production and mailing of such documents. Although the majority of customers still prefer to use the mail, business use of the Internet and electronic communications networks is growing rapidly. Increasing postage rates are driving businesses like DST's clients to push customers to electronic presentment and payment systems. As noted above, DST Output's paper mail volumes increased by 6.7 percent between 2005 and 2006. That growth rate is respectable but the e-solution segment of DST Output's business produced and delivered about 486 million documents in 2006, a 14 percent increase over 2005 and electronic payments increased by 36% during the same period. Accordingly, while paper mail has been, and for the foreseeable future likely will remain, a very important customer communications channel for DST's clients, e-solutions is the fastest growing segment of DST's business.

First Class workshare mail is the most profitable product the Postal Service offers; for every dollar of costs that the Postal Service incurs in providing this service, it receives \$3.00 in revenue. The outstanding profitability of workshare mail has been an extremely valuable financial resource that has allowed the Postal Service to minimize rate increases for First Class single piece mailers and other classes while still expanding its delivery network, even in the face of the recent precipitous decline in single piece mail volumes.

Since inception of the worksharing program, the Postal Service has been able to to **increase** the use and profitability and of this product through the exercise of market dominance. However, the days of the Postal Service's almost total dominance in the workshare mail market may be numbered. Recent technological changes such as the rapid deployment and wide acceptance of the Internet and consumers' increasing comfort with electronic document delivery and bill payment systems has eroded the Postal Service natural market dominant position in the workshare mail market. To remain competitive with alternative electronic communication channels, the Postal Service must diligently control all costs.

Pricing strategies adopted by the Postal Service and the Commission under the new ratemaking framework will also play an increasingly important role in the future of First Class workshare mail. Reasonable, carefully balanced pricing policies have the potential to help the Postal Service retain its profitable workshare mail business. Unwise pricing policies have the potential to accelerate adoption of electronic alternatives.

Rational pricing policy is especially important in First Class where single piece rates can only be increased in full cent increments. DST is concerned that, when annual revenue requirement increases applicable to First Class are not large enough to justify a full cent increase in the single piece rate, the Postal Service may be tempted to use First-Class workshare mail to generate the necessary revenue rather than banking the difference. This could lead to annual postage increases for business mailers that are consistently above inflation.

DST's concerns on this score are not speculative. In R2006-1, First Class workshare mailers were burdened with an above average increase in rates in part because the Commission elected to limit the increase in the basic single piece rate to 41 cents, rather than accept the Postal Service's recommendation for a 42 cent rate.

Modest, predictable postal rate increases are extremely important to DST and its clients. With cooperation from the Postal Service and the Commission, DST should be able to communicate likely rate changes to its clients early enough so that they can build the increased costs into their budgets. However, if rate increases for First-Class workshare mail prove to be less predictable or are higher than the rate of inflation, our clients doubtless will promote readily available alternative electronic document presentment and payment systems more aggressively in order to keep their costs under control. In this regard, two large companies that I receive bills from already have made electronic bill presentment mandatory for their customers who use electronic payment options. Banks and other businesses are offering gift certificates and other inducements for their customers to switch to online bill pay. I saw one recent promotion that offered consumers a one time, \$30 reduction in service charges in return for signing up for electronic bill pay and presentment. Typically, such promotions emphasize that paying bills online is more convenient than paying by mail and will give users more control

over their finances, the ability to avoid late fees by scheduling when bills are paid, and save paper, stamps, and the hassles of paying by check.

The ability to accurately forecast rate increases and other important changes in postal requirements is essential for DST to invest in building new products and make maximum effective use of new postal offerings. A positive example occurred in the R2006-1 rate case where important changes in the First Class rate structure were introduced to reduce cross subsidization inherent in the existing structure. The Postal Service proposed new shape based rates, lower rates for First-Class additional ounces and an increase to 3.5 ounces in the maximum weight for automation letters. DST was able to communicate these changes to its clients far enough in advance to plan and create new systems and procedures to convert lighter flats to letters.

Other examples serve to illustrate that advance notice is not always sufficient to allow mailers to adapt to changes in postal requirements. For example, on August 1<sup>st</sup> of this year, the Postal Service will further tighten address matching software (CASS cycle L) with the integration of Delivery Point Validation (DPV) and LACS<sup>Link</sup> software. Testing and implementation of the new requirements has been difficult, particularly in the mainframe environment. Longer computer processing time and the lack of user-friendly DPV return information will increase costs for DST and its clients. Moreover, addresses that fail DPV will not be eligible for automation discounts. This CASS cycle will increase costs to DST and its clients.

Similarly, DST is a limited service provider of the NCOA<sup>Link</sup> service, which is used by clients to update addresses when customers move. This process definitely is *not* simple, especially when financial or medical clients are involved. DST and its clients must comply with independent regulatory and legal requirements when implementing a move. These requirements, which may entail contacting the customer to confirm accuracy of the move information, delay implementation of the Postal Service's move update requirement and, of course, make the process more costly.

DST also invests considerable time, effort, and money to be sure that its clients' mail pieces conform to all applicable Postal Service standards. DST takes mail piece design very seriously. Using, among other tools, the Postal Service's Mail Quality Control (MQC) program, DST mail piece design specialists work closely with each client

and the Postal Service to ensure that every mail piece complies with Postal Service standards. Compliance with these standards is complicated and costly. The Postal Service publishes an entire manual specifying all applicable standards. Our specialists take a formal certification course to understand and properly implement these complicated requirements. In addition, production samples of mail pieces are reviewed and tested (and redesigned and retested if necessary) to be sure that all automation requirements are met and the production pieces will run on automation equipment. In addition to the physical attributes, DST utilizes software to properly assign the delivery point to each address and produce the Postnet or Intelligent Mail on the mail piece.

DST generally supports these requirements and is proactive in working with our clients to use complete and correct addresses. We have also created products, systems, and electronic files that can simplify much of the work for DST's clients.

The need to implement and conform to such new Postal Service requirements represents an additional, hidden rate increase that only impacts Automation mailers. It is crucial that the Commission and the Postal Service recognize and take these hidden rate increases into account in setting workshare discounts. DST appreciates the need for implementing requirements that improve address cleanliness and accuracy. To DST's clients, however, the unknown but possibly significant and ongoing additional costs they must absorb to participate in the worksharing program leads them to consider alternative communication channels which have more transparent and predictable costs.

**B. The Scope of Workshare Activities That Will Be Included Within the Definition of Worksharing**

DST's second concern with implementation of the new law involves the types of worksharing activities that will be eligible for discounts. With certain exceptions, the new law limits workshare discounts to 100 percent of the costs avoided by the Postal Service. DST supports this feature of the new law in principle. However, it is of paramount importance that the scope of worksharing be clearly defined and a fair process be established for analyzing workshare cost savings and adjusting discounts as necessary.

DST Output facilities in Kansas City, Missouri; Hartford, Connecticut; and El Dorado Hills, California operate 24 hours a day, 365 days a year producing, on the average 5 million mail pieces a day. These are highly efficient operations. DST Output has invested hundreds of millions of dollars to construct the facilities and equip them with cutting edge computer hardware and software. Moreover, DST Output has to make significant, ongoing investments in new equipment, new and updated software, mail handling equipment and employee training just to keep up with changes in technology and changing Postal Service requirements for acceptance, processing and transportation of its workshare mail.

DST Output has always gone the extra mile to insure that its facilities, equipment, personnel, and procedures are the best in the industry. In this regard, the El Dorado Hills and Hartford facilities have been certified by Postal Service under the Mail Preparation Total Quality Management (MPTQM) program. The Kansas City facility is waiting for the Postal Service to conduct the MPTQM certification audit.

DST has automated most of the mail preparation and acceptance processes in order to facilitate the entry of such large volumes of First-Class mail. DST also worked with the Postal Service to establish a Detached Mail Unit (DMU) at each of our facilities. This enables the USPS to conduct mail verification and acceptance at DST Output's site rather than the local Postal Service plant. Special systems have been developed and are accessed by Postal Service personnel to redirect mail trays for acceptance testing. Detailed piece, tray and presort information is readily available to postal employees for matching to the MERLIN results. Some of the infrastructure includes automatic tray conveyor systems, tray banding systems, tray sorting conveyors, automatic scales, and high capacity equipment to shrink wrap pallets of mail trays and load pallets onto large Postal Service trucks.

As part of its mailing agreement with the Postal Service, DST prepares mail trays for direct transportation. DST sorts trays of mail to destination and assigns them to surface or air transportation using the PostalOne! transportation management system. DST has further integrated the PostalOne! system into its mail production processes so that Destination & Routing tags (D&R) are automatically assigned to the trays. This facilitates the processing and transportation of the trays by air carriers. D&R tags are



now an integral part of the performance and payment management with the carriers. Over the years changes have been made to enable the Postal Service to eliminate local handling of these trays. All of these efforts require DST to incur additional costs for labor, maintenance and related supplies.

There can be no doubt that DST Output's initial and ongoing investments in plant, equipment and people have benefited the Postal Service. But for the fact that DST Output established a DMU and streamlined the acceptance of mail, its extremely large daily volumes would inundate the local post offices, require the Postal Service to expand its mail processing facilities or construct new plants, purchase additional, expensive mail processing equipment and hire many more clerks and associated labor, including overtime, to accommodate DST Output's volumes.

DST's use of PostalOne! and all other procedures described above are good examples of work done by mailers that enables the Postal Service to avoid costs but has been excluded from consideration in the derivation of workshare cost savings and establishment of the discount structure for First-Class. This is a win-win situation for the Postal Service; the Service receives the benefits of our extra cost sparing operations and efforts while providing no additional monetary incentives for these worksharing efforts. New technologies, with the associated expansion of workshare opportunities are critical for the Postal Service to retain value for its First-Class communication products. The Postal Regulatory Commission must also embrace these new opportunities to enable worksharing to remain an attractive, cost effective program for mailers.

The problem with the Postal Service's short sighted view of what constitutes worksharing is that, unless workshare mailers like DST receive adequate recognition of the avoided costs enjoyed by the Postal Service, such mailers will not continue to make the substantial investments necessary to keep these highly efficient operations going. DST Output and other high volume workshare mailers will have to divert their valuable financial resources to develop and promote alternative document delivery and payment systems that offer better control of expenses, fewer intrusive requirements and, overall a better return on their investments.

Finally, DST is concerned with some of the costs that are included in workshare mail. I would encourage the Commission increase its understanding of the acceptance,

mail processing, transportation and delivery costs for First-Class bulk mail. Worksharing positively impacts **all** of these costs.

### **C. The Manner In Which Workshare Cost Savings Will Be Measured**

When I reflect upon all of the extraordinary efforts that DST and other workshare mailers make to be sure that their mail pieces meet all the complex standards relating to physical characteristics, address accuracy and address placement, I cannot help but question the fairness of the Commission's current Bulk Metered Mail (BMM) benchmark for measuring workshare cost savings. In **theory**, BMM is assumed to (1) be brought to local bulk mail acceptance facilities in full postal service trays, (2) be automation compatible, (3) have envelope paper quality and typed addresses that meet applicable Postal Service readability requirements, and (4) include addresses that have the same level address accuracy that is **required** of First Class automation mailers. As the Postal Service has increased the number and complexity of requirements applicable to automation mailers, it is becoming increasingly clear to me that BMM is a wholly artificial benchmark that only serves to exclude from consideration substantial additional worksharing that mailers like DST must perform day in and day out.

The new ratemaking process should provide reasonable advance notice of significant changes and, equally important, fair procedures for affected mailers, the Postal Service and the Commission to explore the propriety of the proposed changes. As discussed in MMA's written comments filed earlier this week, workshare mailers have serious, specific concerns about the methodology used by the Commission to measure workshare cost savings in R2006-1. In particular, the Commission's acceptance of NonAutomation, Machinable Mixed AADC (NAMMA) letters as the benchmark to measure delivery cost savings due to worksharing resulted in a **significant** reduction of several cents in the actual cost savings.

Since the Commission did not address the NAMMA and other issues adequately in its R2006-1 recommended decision, it is imperative that the Commission establish adequate remedial procedures to revisit these important issues before it locks in on a methodology for measuring workshare cost savings that will be used to determine if changed or unchanged workshare discounts are in compliance with the standards of the new law.

### **III     Service Standards**

The Commission has asked for comments on how it can fulfill its statutory role in the establishment of the modern service standards. DST appreciates the Commission's efforts and guidance to date on this vital issue. DST is participating actively in the deliberations of the Sub-group focused on First-Class Mail that is part of MTAC Work Group No. 114 that has been set up to formulate Service Standards and Measurements for Market-Dominant Products. To date, the Commission has been supportive of DST's recommendation that service measurement must include tracking the "tail" of the mail, that is mail pieces that are delivered at some unknown time after expiration of the applicable service standard. As the Commission knows well, the Postal Service currently collects no information that would indicate by how much the Service has failed to meet its minimum standard. The availability of more accurate information on the tail of the mail is necessary to identify and remedy serious persistent delivery problems. Therefore, I encourage the Commission to continue its helpful participation in Workgroup No 114.